

Friday, June 9, 1961

Number 146

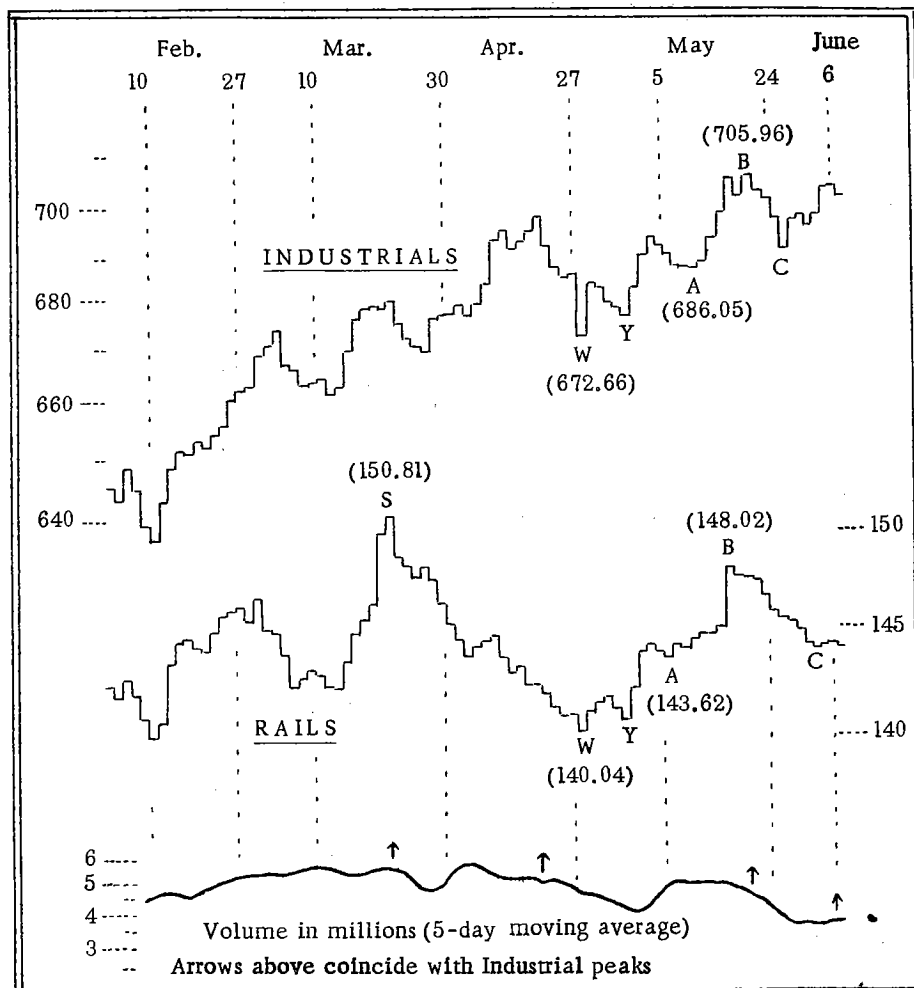
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THE MARKET With rare exceptions, advancing markets never look "beautiful" enough for bulls, and declining markets never look "horrible" enough for bears. For this reason, when a trend becomes established it is best to give it every benefit of the doubt before deciding that it has reversed. Over the last month I have discussed some of the possible bearish nuances of the current bull trend. I will continue to do so, but readers should remember that a reversal entails a breaking of significant preceding points by both Averages. So far on the advance, preceding decline lows have held remarkably intact.

On May 19 the Industrial Average rallied to an all-time high of 705.96 (B on chart). The bullishness of that Industrial performance was considerably diluted by the fact that the Rail Average did not confirm. In fact, two days earlier (May 17), Rails touched a peak of 148.02 at B (2.79 points under their previous high at S) -- then turned down. Following the peak at B, the Rail Average declined for ten consecutive days (B-C), but at C the Rails were still 27¢ above the preceding decline low at A (143.62).

Thus we witnessed an Industrial high recorded on diminishing volume, a non-confirmation by Rails and a short period of Rail divergence (Rails declining while Industrials advance). The appearance of any or all of these factors was sufficient to cast a negative (but not necessarily bearish) cloud over the market.

On May 25 (point C) Industrials turned up for another attack on the high. Despite the lagging Rail Average, the senior Average on June 6 rose to 703.79, less than 3 points from the all-time high at B. Again I draw readers' attentions to the 5-day moving average of volume pictured on the chart. Volume on the most recent peak (June 6) averaged about 4 million shares per day, and this was the lowest volume to appear at any of the last four peaks (see Letter 145).



Many severe reactions (and bear markets) have developed as follows:

- (1) Buying power (upside volume) contracts while prices are still rising.
- (2) Following the initial decrease in upside volume, prices falter -- then turn down.
- (3) Selling pressure (downside volume) expands as the decline gets underway.

In Letter 145 I noted that on each of the last three peaks recorded by the Industrial Average, volume has contracted. Such action suggests a lack of lifting or buying power. Lack of buying power is a negative, but not necessarily bearish indication. It is only when volume expands on declines that we may infer that selling pressure is actually increasing, and this decidedly bearish phenomenon has not (so far) made its appearance.

If the market were in real danger, I would expect first the A points (Industrials 686.05, Rails 143.62), then the W points (Industrials 672.66, Rails 144.02) to be violated, and in both cases I would expect volume to increase.

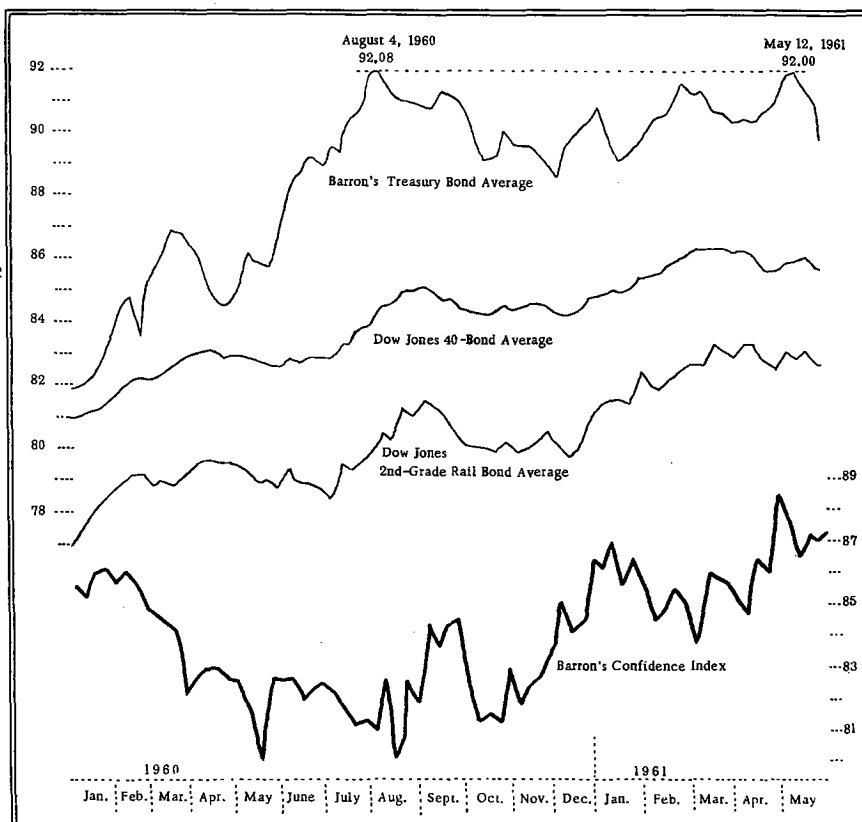
CONCLUSION The primary trend remains bullish. As long as one or both Averages hold above the A points the secondary trend will remain bullish. If the A points are jointly violated on increasing volume, recent purchases should be sold. If the W points are jointly violated on increasing volume, few if any stocks should be held.

BONDS AND THE CONFIDENCE INDEX (C.I.) The trends of the bond averages (see Letter 127) and the Confidence Index are worth discussing again at this juncture. The C.I. is merely the ratio of the yield on Barron's 10 highest grade bonds and the yield on the broadly representative D-J Bond Average. Theoretically, if sophisticated bond money grows cautious, it will switch into the highest grade bonds -- thus forcing the yield on those bonds down and causing the C. I. to decline. Conversely, if bond buyers feel confident enough to foresake safety for yield, they will move into generally higher yielding bonds as represented by the D-J 40 Bonds. This will cause the yield on the D-J 40 Bonds to decrease (in comparison to the yield on the higher grade bonds), and the C.I. will rise. Since bond money is "supposed" to be more informed than equity money, the movements of the C.I. are said to precede stock market movements by two to four months.

The most volatile components of the D-J 40 Bond Average are the fast-moving 2nd-grade rail bonds. Note on the chart how the 2nd-grade rail bonds tend to outpace the D-J 40 Bonds in both directions. For this reason, many students believe that the 2nd-grade rail bonds are practically an index of confidence in themselves.

On February 20, 1961, the Federal Reserve Board announced the inauguration of its "nudging" operations. Nudging is the Government's program for lowering interest rates by purchasing longer-term bonds in the open market. Barron's highest grade bonds are necessarily affected to some extent by the movements of Treasury bonds. For this reason it is highly probable that the Fed's action caused Barron's highest grade bonds to decline in yield in sympathy with Treasury bonds. This would have the effect of artificially lowering the C.I.

Whether it was this possible "manipulation" which recently threw the C.I. askew, or whether it was some other factor cannot be known. What is notable, however, is that the C.I. has not even rallied above its previous peak of 89.7 (recorded in September, 1960). Thus instead of leading the Averages as is its usual custom, the C.I. has lagged behind and never given the signal for that which has already occurred!



Two weeks ago Treasury bonds started declining. It is fascinating to note that the decline began from the May 12, 1961 peak of 92.00 on Barron's Treasury Bond Index (see chart). This peak was exactly 8¢ below the previous peak registered by Barron's Index at its August 4, 1960 high.

It is also important to observe that although the D-J 40 Bond Average and the 2nd Grade Rail Bond Average are now well above their 1960 highs, the Treasury Bond Average halted just under its 1960 high and turned down. The extended rise in the C.I. since August, 1960, has been largely a result of the superior performance (and therefore lower yields) of the D-J 40 Bonds as compared to the high-grade bonds as typified by the Treasury Average. If Treasury bonds continue their current decline while the D-J 40 bonds either hold or advance, the C.I. will rise, thus providing a (belatedly) bullish forecast for the market.

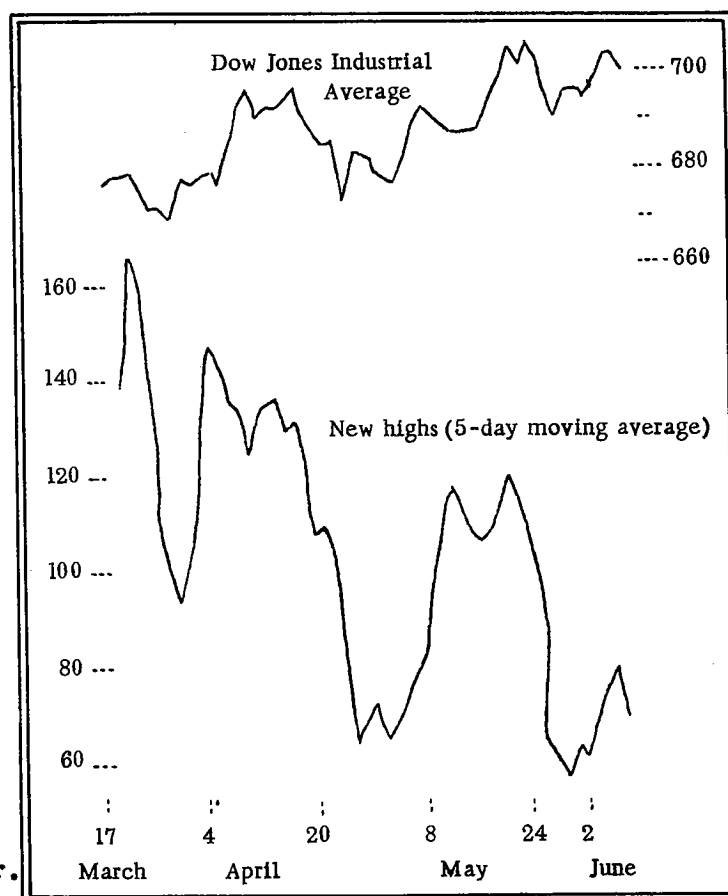
From another standpoint, this writer will be most interested to see whether Treasury bonds (with or without the Fed's "help") can manage to hold their ground. For if the Kennedy administration continues to manufacture new budget deficits (and deficits imply additional Treasury financings), it is certain that something more than "nudging" will be required to prop up the declining Treasury market.

Last week Federal Reserve Board Chairman Martin brought the matter out into the open by stating that interest rates "will continue to rise" if business continues to improve. This is in direct conflict with the lower interest rates policy espoused by President Kennedy and his economists. An interesting altercation could be in the making.

NEW HIGHS One of the indications of a powerful advance is an expanding number of new highs. Conversely, a sign of technical weakness during a decline is a steadily increasing number of new lows.

In the last Letter I drew attention to the diminishing upside volume, and I stated that such action often precedes or coincides with a lag or downturn in the advance-decline ratio. While it is still too early to draw any definitely bearish conclusion, it is worth noting that the advance-decline ratio has declined since May 25 (while Industrials rallied). This will be discussed in more detail in the next Letter.

A second characteristic of the recent rally has been the diminishing number of new highs. The accompanying chart shows new highs plotted on a five-day moving average. Note the steady diminution of new highs at the April, the late May and the most recent Industrial peak. This phenomenon tends to confirm the negative appearance of the lagging volume curve and the sluggish advance-decline ratio. To sum up, the market is now showing considerably less "steam" than was shown at any previous peak this year.



STOCKS Continuing our discussion of the Dow stocks, the chart on page 4 shows American Telephone (T) breaking above its 30-week moving average (M.A.) in November, 1960, and embarking upon a spectacular advance. By early April, T had rallied 22 points above its M.A. It seems to be a characteristic of stocks that when they rise too far above their M.A., they are extremely vulnerable to a correction. Such a correction was seen recently in T. The stock is still in a bull trend and is holding well above its M.A., which is now 113.

Because the recent offering of "rights" brought in a great many speculative "special subscriptions" (which allow margins of 25%), it is probable that T is now one of the key stocks on the Board.

Should T break below 113, thousands of special subscription accounts would "run for the hills". Conclusion: watch T on any continuing weakness; a violation of 113 would probably affect the entire market.

Anaconda recently hit a high of 65. Since its M. A. is only 51 7/8, it would seem that this stock has also gone too far and too fast.

International Harvester has been rising gradually higher since September, 1960. The M. A. is now 48 1/4, and the stock has recently been hovering under its 1959 peak of 57 3/8. The stock remains in a bullish trend.

Sears Roebuck With little or no fanfare, Sears has been one of the strongest stocks in the Average. Last week it rose to an all-time high, well above its M. A. which is now 57 3/4. Sears earned about \$1.80 in 1950 and sold for 13 to 18. This year it may earn around \$2.75 and it is selling for 65. A strong stock but hardly a "value".

U. S. Steel (see Letter 134) I consider Steel to be bullish as long as it holds above 83-4. Between March and May Steel tested the 85 level on four separate tests. M. A. is now 83 1/8.

In Letter 137 I wrote that Zenith (ZE) had formed "a giant symmetrical triangle" and that "a closing above 132 would make ZE a buy". For some happy reason, a large number of subscribers did buy ZE at about 135, and I have received a number of letters asking for additional trading advice. The dotted area on the chart shows the aforementioned triangle. It is a characteristic of triangles that when they break above or below the trend lines, the move usually continues for a (minimum) distance which can be measured by drawing a line parallel to the trendline opposite the "breakout". The line market "A" on the chart measures the minimum upside expectation of ZE following the "buy signal". As seen on the chart, ZE has more than fulfilled its minimum upside measurement and holders of ZE are now "on their own", technically speaking. Nobody can tell a man with a profit exactly when to take that profit. However, it is usually good practice to sell at least half of one's holdings of a stock that has rallied to a point where the minimum expectations of a triangle have been fulfilled. (Chart of Zenith courtesy of Traders Research Inc., 6185 Lambert Airport, Missouri)

Written Thursday, June 8, 1 P. M.

